Building a better working world

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Malaysian developments

Principal Hub (PH) incentive

In Budget 2021, the Government proposed that the application period for the PH incentive be extended for two years, until 31 December 2022. It was also proposed that the qualifying conditions relating to the number of high value jobs, annual operating expenditure and number of key posts be relaxed for the second five-year period of the incentive (see *Take 5: Malaysia Budget 2021*).

Following the above, the Malaysian Investment Development Authority (MIDA) published on its website the "Guidelines for Principal Hub Incentive 3.0" (Guidelines for PH 3.0), which were effective from 1 January 2021 (see *Tax Alert No. 20/2021*).

To legislate the above, the Income Tax (The Principal Hub Incentive Scheme) Rules 2022 [P.U.(A) 164] were gazetted on 24 May 2022.

The Rules provide that a qualifying company which carries on a qualifying activity under the PH Incentive Scheme will be eligible for a concessionary tax rate on the chargeable income for the specified years of assessment (YAs), as stipulated in Schedule 2 to the Rules (outlined in Appendix II to this Alert). The specified YAs are for a period of five consecutive YAs, commencing from the YA as determined by the Minister.

Applications for the incentive must be received by the Minister through MIDA between 1 January 2021 and 31 December 2022. The qualifying company which applies for the incentive must comply with the relevant conditions based on the category applicable to the said company (see Appendix II), any other conditions imposed by the Minister as specified in the approval letter, and the latest relevant Guidelines for PH 3.0.

The following terms are defined in the Rules:

(a) Qualifying activity

Service activity undertaken by a qualifying company as specified in Schedule 1 to the Rules (outlined in Appendix I to this Alert)

(b) PH Incentive Scheme

Incentive scheme for the qualifying company which carries on a qualifying activity and approved by the Minister

(c) New company

A company which:

(i) Is incorporated under the Companies Act 2016 and resident in Malaysia,

(ii) Has paid-up capital of more than RM2.5 million, and

(iii) Is established for the purpose of carrying on a qualifying activity under the Rules, which:

a. Does not have an existing entity or related entity in Malaysia prior to the application for the incentive; or

b. Has an existing entity or related entity in Malaysia which has not carried on a qualifying activity in Malaysia prior to the application for the incentive

(d) Existing company

A company which:

(i) Is incorporated under the Companies Act 2016 and resident in Malaysia,

(ii) Is already operating in Malaysia and carrying on a manufacturing or services activity other than the qualifying activity prior to the application for the incentive

(iii) Has paid-up capital of more than RM2.5 million

(e) Qualifying company

New or existing company that fulfills the eligibility conditions imposed by the Minister under the Income Tax Act 1967 (ITA) and the Rules

The Rules provide that in ascertaining the statutory income of a qualifying company, intellectual property (IP) income derived from the qualifying activity of the qualifying company shall be excluded. The IP income will not qualify for the tax incentive and will be subject to tax at the prevailing rate.

The specified YAs for the incentive in respect of a new company may be extended for a further five YAs, subject to the fulfilment of conditions specified in Schedule 3 to the Rules (outlined in Appendix III to this Alert) and any other conditions imposed by the Minister as specified in the approval letter. Applications for the extension must be received by the Minister through MIDA within 30 days before the expiry of the specified YAs.

The Rules also provide that the Minister may allow the qualifying company to surrender the incentive granted, by providing notice in writing to the Minister through MIDA, except in situations where the qualifying company fails to comply with any conditions imposed in relation to the incentive. The surrender of the incentive shall take effect from the first day in the basis period for the YA in which the application for the surrender of the incentive is received by the Minister through MIDA.

The non-application provisos stipulate that the Rules will not apply to a qualifying company which has in the specified YAs:

(a) Made a claim for allowances under Schedules 7A or 7B of the ITA
(b) Been granted any incentive under the Promotion of Investments Act 1986
(c) Been granted an exemption under Sections 127(3)(b) or 127(3A) of the ITA
(d) Been approved by the Minister an incentive scheme under any rules made under Section 154 of the ITA
(e) Made a claim for deduction under any rules made under Section 154 of the ITA except:
    (i) The rules in relation to allowance in Schedule 3 of the ITA,
    (ii) The Income Tax (Deduction for Audit Expenditure) Rules 2006, or
    (iii) The Income Tax (Deduction for Expenses in relation to Secretarial Fee and Tax Filing Fee) Rules 2020

The Rules are effective from YA 2021.

Tax incentive for the Industry4WRD Vendor Development Programme (IVDP)

The Industry4WRD policy, launched on 31 October 2018, was developed to propel Small and Medium Enterprises (SMEs) forward to meet the challenges posed by the Fourth Industrial Revolution. The policy was formulated based on three key principles:
(a) To encourage stakeholders to apply Industry 4.0 (I4.0) technology
(b) To create a comprehensive ecosystem for I4.0 application by industry
(c) To transform the manufacturing sector holistically

To achieve the aspirations above, various measures as well as tax incentives were proposed in Budget 2019, including a double deduction on expenses incurred by anchor companies in implementing the IVDP, capped at RM1 million per year for three consecutive YAs (see *Special Tax Alert: Highlights of 2019 Budget – Part I*).

To legislate the above-mentioned proposal, the Income Tax (Deduction for Expenditure in relation to Industry4WRD Vendor Development Programme) Rules 2022 [P.U.(A) 172] were gazetted on 30 May 2022.

The Rules provide that in ascertaining the adjusted income of an anchor company from its business for a YA, a double deduction shall be allowed for expenditure* incurred by the company in carrying out the following activities in relation to the IVDP in the basis period for that YA:

(a) Activities in relation to product development, namely product quality upgrading, product innovation or research and development
(b) Activities in relation to capability upgrading, namely certification programme, assessment programme or business process re-engineering, or
(c) Activities in relation to human capital, namely hard-skills training, lean management system, financial management practice or capacity upgrading

** Does not include capital expenditure incurred on plant, machinery, fixtures, land, premises, buildings, structures or works of a permanent nature or on alterations, additions or extensions thereof or in the acquisition of any rights in or over any property*

The amount of expenditure shall be verified by the Minister charged with the responsibility for international trade and industry and shall not exceed RM1 million for each YA. The double deduction can be claimed for three consecutive YAs, commencing from the YA the first expenditure is incurred.

The Rules stipulate that the IVDP is a programme certified by the ministry charged with the responsibility for international trade and industry (i.e., MITI) or agency, to be implemented by an anchor company in developing a vendor company, as specified in the Guideline for the Implementation of IVDP issued or as revised by MITI and approved by the Minister (Guideline).

The following terms are defined in the Rules:

(a) Agency
Agency appointed by MITI under the IVDP

(b) Vendor company
A company which:
(i) Is incorporated or deemed to be registered under the Companies Act 2016,
(ii) Is a Malaysian-resident,
(iii) Engages in manufacturing or manufacturing-related services sectors, and
(iv) Fulfills other conditions as specified in the Guideline

The Rules shall apply to an anchor company which:

(a) Is incorporated or deemed to be registered under the Companies Act 2016,
(b) Is a Malaysian-resident,
(c) Engages in manufacturing or manufacturing-related services sectors,
(d) Holds a business license issued by the relevant local authority and a manufacturing license issued by MITI, if relevant,
(e) Has been in operation for a period of at least 36 months,
(f) Participates in the IVDP,
(g) Signs a memorandum of understanding with MITI between 1 January 2019 and 31 December 2021, and
(h) Fulfills other conditions as specified in the Guideline

The Rules are deemed to have come into operation from YA 2019.

Overseas developments

Hong Kong Court rules booked trading profits are not necessarily subject to profits tax

Hong Kong's Court of First Instance (CFI) recently handed down a favourable decision which clarified that profits tax liabilities are imposed on what a taxpayer has done to earn the profits in question, as opposed to what its role or purpose in Hong Kong is, notwithstanding that its role in Hong Kong is to mitigate the overseas tax liabilities of its group.

Detailed discussion

The taxpayer was a private limited company incorporated in Hong Kong engaged in the trading of electronic products. It purchased products from two independent Hong Kong suppliers and sold them to its group company in the Netherlands. All the business operations of the taxpayer were conducted by affiliates outside Hong Kong, while its only connection with Hong Kong was limited to having a bank account in Hong Kong.

The CFI held that the taxpayer's booked profits are not subject to Hong Kong profits tax, on the basis that: (i) it did not carry on a trade or business in Hong Kong; and (ii) all the commercial operations relevant to the production of the trading profits were performed outside Hong Kong.

The CFI held that a Hong Kong incorporated company with limited activities carried out in Hong Kong, such as operating a Hong Kong bank account from outside Hong Kong and maintaining a registered office in Hong Kong, would not normally be regarded as carrying on a business in Hong Kong. The locality of the Hong Kong suppliers' business was irrelevant.

In the context of a trading business, the CFI considered that operating a bank account to settle payments due to suppliers and receive payments from customers would not by itself amount to profit-producing activities. They were incidental acts done after the formation of the profit-generating contracts of purchase and sale and would not generally be relevant for determining the source of trading profits. While the tax planning arrangement undertaken by the group prevented a portion of the profits from being charged to tax anywhere, it was not relevant in determining the source of profits.

UK delays reporting rules for digital platforms

The United Kingdom (UK) Tax Authority, Her Majesty's Revenue and Customs (HMRC) has issued an update on the UK's reporting rules for digital platforms.

Following a recent consultation on the implementation of the OECD's Model 'Reporting rules for digital platforms', the UK Government has decided that the new rules will start from 1 January 2024. This new date is intended to give platforms and their advisors time to prepare for the implementation of the new rules, with the collection of information starting from 1 January 2024 and the submission of the first reports due by the end of January 2025.

Further, HMRC has said that it is currently considering the many comments and issues that have been raised by the consultation respondents. HMRC is aiming to publish the Government's response to the consultation, draft regulations giving details of the new rules, and provide an update on interactions with the European Union (EU) rules in this area (referred to as DAC7) this summer. HMRC has said that it will also be engaging with platforms and their advisors before the new rules come into effect.

Background

New rules being introduced in the EU and the UK will require digital platforms to report income earned by sellers using their systems to the respective tax authorities. Enhanced platform reporting is also being introduced in the United States from 2022 (1099-K).

The EU/UK rules will impact:

- Digital platforms that allow sellers to:
  - Rent immovable property (e.g., short-term accommodation)
  - Provide personal services (e.g., on-demand household/professional services)
  - Rent transport
  - Sell goods
- Sellers who utilise platforms to provide in-scope activities.

Implications

While the announcement that the UK reporting is delayed may be generally welcomed by platforms as an opportunity to have more time to adapt to new rules, the deferral may not be beneficial to all platforms based in the UK. Platforms that deal with sellers in the EU will now be required to report in an EU country in 2024 rather than reporting in the UK, as a result of extraterritorial provisions in DAC7.

APPENDIX I

Qualifying services under the PH Incentive Scheme

Type of services	Description
Strategic services	▸ Regional profit and loss or business unit management ▸ Strategic business planning and corporate development ▸ Corporate finance advisory services ▸ Brand management ▸ IP management ▸ Senior-level talent acquisition and management
Business services	▸ Bid and tender management ▸ Treasury and fund management ▸ Research, development and innovation ▸ Project management ▸ Sales and marketing ▸ Business development ▸ Technical support and consultancy ▸ Information management and processing ▸ Economic or investment research analysis ▸ Strategic sourcing, procurement and distribution ▸ Logistic services
Shared services	▸ Corporate training and human resource management ▸ Finance and accounting (transactions, internal audit)

APPENDIX II

Applicable tax rate and conditions for a qualifying company under the PH Incentive Scheme

Categories of qualifying company	Category 1 (New company that does not have an existing entity or related entity in Malaysia prior to the application for the incentive)	Category 2 (New company that has an existing entity or related entity in Malaysia which has not carried on a qualifying activity in Malaysia prior to the application for the incentive)	Category 3 (Existing company)
Income tax rate	0%	5%	10%
Conditions for a qualifying company under the PH Incentive Scheme			
Minimum number of full-time new employees in Malaysia with a basic salary of at least RM5,000 per month. At least 50% of new employees must be Malaysians.	50	30	30
Minimum number of full-time new employees in Malaysia with a basic salary of at least RM25,000 per month.	5	4	5
Minimum amount of annual operating expenditure in Malaysia	RM10 million	RM5 million	RM10 million

Applicable tax rate and conditions for the extension of the specified YAs for a new company under the PH Incentive Scheme

Categories of qualifying company	**Category 1** (New company that does not have an existing entity or related entity in Malaysia prior to the application for the incentive)	**Category 2** (New company that has an existing entity or related entity in Malaysia which has not carried on a qualifying activity in Malaysia prior to the application for the incentive)
Income tax rate	0%	5%
Conditions for the extension of the specified YAs for a new company under the PH Incentive Scheme		
Minimum number of full-time new employees in Malaysia with a basic salary of at least RM5,000 per month. At least 50% of new employees must be Malaysians.*	60	36
Minimum number of full-time new employees in Malaysia with a basic salary of at least RM25,000 per month.*	5	4
Minimum amount of annual operating expenditure in Malaysia*	RM13 million	RM7 million

**To be complied with at the end of the last year of the specified YAs*

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Important dates

15 June 2022	Due date for monthly instalments
30 June 2022	6th month revision of tax estimates for companies with December year-end
30 June 2022	9th month revision of tax estimates for companies with September year-end
30 June 2022	Special 11th month revision of tax estimates for YA 2022, for companies with July 2022 year-end
30 June 2022	Statutory deadline for filing of 2021 tax returns for companies with November year-end. A blanket extension of time has been provided until 31 July 2022.
30 June 2022	Extended 2021 tax return filing deadline for companies with October year-end.
15 July 2022	Due date for monthly instalments
31 July 2022	6th month revision of tax estimates for companies with January year-end
31 July 2022	9th month revision of tax estimates for companies with October year-end
31 July 2022	Special 11th month revision of tax estimates for YA 2022, for companies with August 2022 year-end
31 July 2022	Statutory deadline for filing of 2021 tax returns for companies with December year-end. A blanket extension of time has been provided until 31 August 2022.
31 July 2022	Extended 2021 tax return filing deadline for companies with November year-end.

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